



The Northern Trust Company, Canada  
Basel III Pillar III Disclosure  
as at September 30, 2013

October 30, 2013

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## NORTHERN TRUST OVERVIEW & SCOPE OF APPLICATION

This document presents the capital structure and capital adequacy calculations based on Basel III guidelines on both an “All-in” and a “Transitional” basis. The Office of the Superintendent of Financial Institutions Canada (OSFI) requires all institutions to implement the Basel III framework. TNTCC complies with the Basel III framework as it applies:

- Pillar 1: Minimum Capital Requirements. Senior management and The Northern Trust Company, Canada (TNTCC) Board of Directors have adopted the Standardized Approach to Credit Risk and the Basic Indicator Approach to Operational Risk to determine the company’s capital requirements under Basel Capital Adequacy Reporting (BCAR);
- Pillar 2: The Supervisory Review Process. TNTCC completes an Internal Capital Adequacy Assessment Process (ICAAP) at least annually, with the results reviewed and approved by the TNTCC Board of Directors; and
- Pillar 3: Market Discipline. This Pillar 3 disclosure document has been prepared in order to comply with regulatory requirements to provide information on TNTCC’s risk management objectives and policies, its capital position, its approach to assessing the adequacy of its capital and its exposure to material risks.

TNTCC was, by Letters Patent of Continuance, continued as a trust company under the *Trust and Loan Companies Act* (Canada) in July 1993 and OSFI issued an order approving TNTCC to commence and carry out trust business in January 1994. TNTCC is a wholly owned subsidiary of The Northern Trust Company (TNTC) and is a federal Canadian Trust Company regulated by OSFI and by TNTC’S lead regulator, the Federal Reserve Bank of Chicago (FRBC).

The business activities of TNTC in Canada are comprised of global custody and associated services, securities lending, asset management and fund administration services. These services are delivered through three Canadian regulated entities: TNTCC, the Canada Branch of TNTC (Canada Branch) and NT Global Advisors, Inc. (NTGA Canada). TNTC, through its three Canadian entities, is a mid-sized financial services provider in the Canadian market place.

To ensure that TNTCC maintains sufficient regulatory capital at all times, TNTCC manages its assets and liabilities in accordance with TNTCC’s Board of Directors approved criteria set forth in its Asset and Liability Management (ALCO) Policy. The ALCO Policy provides the basis for the TNTCC’s credit risk management and provides guidelines to govern the investment in securities and money market assets.

TNTCC does not currently engage in any activities that result in off-balance sheet exposures. Accordingly, its capital requirements are relatively stable.

## **Northern Trust Risk Management**

TNTC has established an integrated Enterprise Risk Management Framework (ERM) that provides for a consistent understanding of risk management throughout the organization, including TNTCC, and acts as a reference of how various components are defined, aligned and linked to capital adequacy. It allows for active management of risk in conjunction with defined risk appetites.

TNTCC's risk appetite is low to moderate and its attitude toward risk is best described as judicious, with a long-term objective of stability. TNTCC's very strong capital base and liquid balance sheet enable it to pursue strategic growth opportunities and manage unexpected events. Risk is effectively managed by a comprehensive risk management program which involves related Northern Trust entities, as required.

This report is unaudited and is reported in Thousands of Canadian Dollars, unless otherwise disclosed.

## **LOCATION AND FREQUENCY OF DISCLOSURE**

This disclosure is updated as required and published on NTC's website ([www.northerntrust.com](http://www.northerntrust.com)) on a quarterly basis.

## CAPITAL STRUCTURE

TNTCC is a wholly owned subsidiary of TNTC. The capital structure of TNTCC consists of Common Shares, Retained Earnings and Contributed Surplus. TNTCC has authorized an unlimited number of common shares without par value. As at September 30, 2013, TNTCC had 30,000 common shares issued fully paid and outstanding.

**Table 1 - Capital Structure**

The table below provides a breakdown of TNTCC's capital structure:

	Q3 2012	Q4 2012	Q1 2013	Q2 2013	Q3 2013
<b>Tier 1 Capital</b>					
Share Capital	30,000	30,000	30,000	30,000	30,000
Contributed Surplus	983	983	983	983	983
Retained Earnings	8,104	8,704	9,160	10,006	10,643
<b>Total Tier 1 Capital<sup>1</sup></b>	<b>39,087</b>	<b>39,687</b>	<b>40,143</b>	<b>40,989</b>	<b>41,626</b>
<b>Total Capital</b>	<b>39,087</b>	<b>39,687</b>	<b>40,143</b>	<b>40,989</b>	<b>41,626</b>

1. All capital held by TNTCC is Tier 1 Capital.

## CAPITAL ADEQUACY

TNTCC has a thorough process to assess capital adequacy built around an internal view of its risk profile and a comprehensive capital planning process.

Projections of regulatory and internal capital requirements and available capital are compared to assess TNTCC's capital adequacy over a multi-year time period. Understanding regulatory and internal capital requirements, as well as available capital levels, under different circumstances is an important component of an entity's capital adequacy assessment. TNTCC's capital adequacy is assessed quarterly and is based on the Board of Directors-approved Capital Management Policy and Capital Management Guideline (CMG).

**Table 2 - Transitional Basis**<sup>1</sup>

This table provides capital disclosure under the “Transitional” basis as required by OSFI for the “Interim Period” and is provided in the table below:

(CAD \$'000s)	<b>Q1 2013</b>	<b>Q2 2013</b>
<b>Common Equity Tier 1 capital: instruments and reserves</b>		
1 Directly issued qualifying common share capital (and equivalent for non-joint stock companies) plus related stock surplus	30,000	30,000
2 Retained earnings	10,143	10,989
6 Common Equity Tier 1 Capital (CET1)	40,143	40,989
12 Additional Tier 1 Capital (AT1)	-	-
13 Tier 1 Capital (T1 = CET1 + AT1)	40,143	40,989
20 Tier 2 Capital (T2)	-	-
21 <b>Total Capital (TC = T1 + T2)</b>	<b>40,143</b>	<b>40,989</b>
22 <b>Total Risk Weighted Assets</b>	<b>31,135</b>	<b>31,628</b>
<b>Capital ratios – Transitional Basis</b>		
23 Common Equity Tier 1 (as a percentage of risk weighted assets) (%)	128.93	129.60
24 Tier 1 (as a percentage of risk weighted assets) (%)	128.93	129.60
25 Total Capital (as a percentage of risk weighted assets) (%)	128.93	129.60
<b>Capital ratios – All-in Basis</b>		
26 Common Equity Tier 1 (as a percentage of risk weighted assets) (%)	128.93	129.60
27 Tier 1 (as a percentage of risk weighted assets) (%)	128.93	129.60
28 Total capital (as a percentage of risk weighted assets) (%)	128.93	129.60

1. *Numbering in the above table corresponds to the OSFI prescribed template*

### Table 3 - Modified Capital Disclosure Template <sup>1</sup>

The table below represents a modified version of the “All-in” capital disclosure template required by OSFI for Non-Domestic Systemically Important Banks commencing in Q3, 2013:

(CAD \$'000s)

	Q3 2013	Q2 2013
	All-in	Transitional
<b>Common Equity Tier 1 capital: instruments and reserves</b>		
1 Directly issued qualifying common share capital (and equivalent for non-joint stock companies) plus related stock surplus	30,000	
2 Retained earnings	11,626	
6 Common Equity Tier 1 capital before regulatory adjustments	41,626	
29 Common Equity Tier 1 capital (CET1)	41,626	40,989
36 Additional Tier 1 capital before regulatory adjustments	-	
44 Additional Tier 1 capital (AT1)	-	
45 Tier 1 capital (T1 = CET1 + AT1)	41,626	40,989
58 Tier 2 capital (T2)	-	
59 <b>Total capital (TC = T1 + T2)</b>	<b>41,626</b>	<b>40,989</b>
60 <b>Total risk-weighted assets</b>	<b>32,531</b>	<b>31,628</b>
<b>Capital ratios</b>		
61 Common Equity Tier 1 (as percentage of risk-weighted assets)	127.96	129.60
62 Tier 1 (as percentage of risk-weighted assets)	127.96	129.60
63 Total capital (as percentage of risk-weighted assets)	127.96	129.60
<b>OSFI all-in target</b>		
69 Common Equity Tier 1 capital all-in target ratio	7%	

1. Numbering in the above table corresponds to the OSFI prescribed template

#### OSFI “All-in” Target

OSFI expects all institutions to attain target capital ratios plus a conservation buffer (2.5%). This means an “all-in” target common equity tier 1 (CET1) ratio of 7% as at the first quarter of 2013. “All-in” target capital ratios of 8.5% for total tier 1 and 10.5% for total capital are expected by the first quarter of 2014.

## Table 4 - Capital Requirements

The Pillar III capital requirements of TNTCC as at September 30, 2013 are provided in the following table:

(CAD \$'000s)	Q3 2012	Q4 2012	Q1 2013	Q2 2013	Q3 2013
<b>Capital Requirements for Credit Risk</b>					
Deposits with Regulated Financial Institutions	4,615	5,980	5,108	5,976	4,484
Risk Weighted - Deposits with Regulated Financial Institutions	923	1,196	1,022	1,195	897
Government Treasury Bills	31,823	31,701	33,259	33,248	34,808
Risk Weighted - Government Treasury Bills	-	-	-	-	-
Other Assets	5,836	4,967	4,663	4,895	5,346
Risk Weighted - Other Assets	5,836	4,967	4,663	4,895	5,346
<b>Total Risk Weighted Assets for Credit Risk</b>	<b>6,759</b>	<b>6,163</b>	<b>5,685</b>	<b>6,090</b>	<b>6,243</b>
<b>Capital Requirements for Operational Risk</b>					
Average three year gross income	13,371	13,357	13,573	13,622	14,019
<b>Total Risk Weighted assets for Operational Risk</b>	<b>25,075</b>	<b>25,050</b>	<b>25,450</b>	<b>25,538</b>	<b>26,288</b>
<b>Total Risk Weighted Assets</b>	<b>31,834</b>	<b>31,213</b>	<b>31,135</b>	<b>31,628</b>	<b>32,531</b>



## Table 5 - Assets to Capital Multiple (ACM)

The components and calculation of the ACM for TNTCC as at September 30, 2013 is provided in the following table:

(CAD \$'000s)	Q3 2012	Q4 2012	Q1 2013	Q2 2013	Q3 2013
Net on balance sheet assets	42,274	42,648	43,030	44,119	44,638
Total Capital	39,087	39,687	40,143	40,989	41,626
Assets to Capital Multiple	1.08	1.07	1.07	1.08	1.07

## CREDIT RISK

Credit risk is the risk to earnings and/or capital arising from the failure of a borrower or counterparty to perform on an obligation.

The primary sources of credit risk for TNTCC derive from issuer risk (as it pertains to Canadian government securities), counterparty risk (as it pertains to cash balances maintained with our nostro bank agent and client fee receivables) and concentration risk (as it pertains to concentrated exposure to Canadian sovereign debt).

The credit risk management process is documented in the TNTCC ALCO Policy. Central to this process is approval and monitoring of exposures. The nature of TNTCC's business is not to provide traditional commercial credit; it is not part of TNTCC's business plan to have a portfolio of loans. The ALCO Policy has been established and is maintained by the TNTCC Board of Directors to govern activities related to interest rate sensitivity, liquidity, the pledging of assets, and large exposures in accordance with the OSFI Guidelines.

Monitoring of client receivables is the responsibility of TNTCC. Exposures, including aging of such receivables, are reported to Management on a monthly basis. Actions are taken as and if necessary based on that review.

TNTCC credit risk is limited to Canada.

Given TNTCC's narrow business model, balance sheet, counterparties, product offerings and the extremely low risk nature of the credit exposures (predominantly Government of Canada securities), credit risk is not material for TNTCC.

## Table 6 - Residual Contract Maturity Breakdown

A breakdown of TNTCC's credit risk exposure by maturity as at September 30, 2013 is provided in the table below:

(CAD \$'000s)	Q3 2012	Q4 2012	Q1 2013	Q2 2013	Q3 2013
<b>Floating rate</b>	4,615	5,980	5,108	5,976	4,484
1 day to 1 month	-	-	-	2,800	21,586
Over 1 month to 3 months	21,577	7,484	11,776	9,976	-
Over 3 months to 6 months	7,465	2,788	-	11,562	4,288
Over 6 months to 1 year	2,781	21,429	21,483	8,910	8,934
<b>Total Credit Gross Exposure</b>	<b>36,438</b>	<b>37,681</b>	<b>38,367</b>	<b>39,224</b>	<b>39,292</b>

### GENERAL DISCLOSURE FOR EXPOSURES RELATED TO COUNTERPARTY CREDIT RISK

For TNTCC, counterparty risk pertains to cash balances maintained with a nostro bank agent and client fee receivables.

Northern Trust Corporation (NTC's) Sub-custodian Oversight Committee is charged with evaluating proposals for the appointment or replacement of nostro bank agents for use by NTC legal entities. Upon review by the Sub-custodian Oversight Committee, TNTC's Counterparty Risk Management Committee is ultimately responsible for approving all such appointments and replacements.

The nostro agent banks are usually systemically important banks. Exposures are monitored carefully and the assessment and approval of the network of nostro agents is focused on systemically important banks.

TNTCC utilizes the credit ratings from Standard and Poor's (S&P) for purposes of determining its capital adequacy.

## Table 7 - Credit Exposure by Counterparty Type

A breakdown of TNTCC's credit risk exposure by asset class is provided in the table below:

(CAD \$' 000s)	Q1 2013			Q2 2013			Q3 2013		
	Exposure (Gross)	Exposure (Net)	RWA	Exposure (Gross)	Exposure (Net)	RWA	Exposure (Gross)	Exposure (Net)	RWA
Sovereign <sup>1</sup>	33,259	33,259	-	33,248	33,248	-	34,808	34,808	-
Bank <sup>2</sup>	5,108	5,108	1,022	5,976	5,976	1,195	4,484	4,484	897
<b>Total</b>	<b>38,367</b>	<b>38,367</b>	<b>1,022</b>	<b>39,224</b>	<b>39,224</b>	<b>1,195</b>	<b>39,292</b>	<b>39,292</b>	<b>897</b>

1. This asset class covers all exposures to counterparties treated as sovereigns under the standardized approach

2. This asset class covers exposures to banks and some securities firms

## MARKET RISK DISCLOSURES AND LIQUIDITY RISK

Market risk results primarily from the sensitivity of the value of assets and liabilities, as well the sensitivity of net interest income, to changes in interest rates. Secondly, market risk results from changes in the value of trading positions due to movements in foreign exchange rates and interest rates.

Market & Liquidity risk is comprised of three sub-risks:

- Trading risk - risk of loss in trading positions from changes in the value of the trading position
- Interest rate risk - risk of loss due to significant unexpected changes in interest rates
- Liquidity funding risk - risk of loss due to the inability to raise capital to meet business needs

TNTCC engages in no trading activity and therefore has no trading risk.

Liquidity is not required to meet deposit liabilities of TNTCC as TNTCC is not engaged in banking activities and does not have any deposits. Sufficient working capital is maintained at all times to meet business requirements. Core investments are held in third-party bank deposits and Canadian government securities, which are considered liquid assets given their short maturities and marketability.

## OPERATIONAL RISK

Operational risk is the risk of loss from inadequate or failed internal processes, people and systems or from external events. Operational risk reflects the potential for inadequate information systems, operating problems, product design and delivery difficulties or catastrophes to result in unexpected losses. TNTCC uses the basic indicator approach to measure operational risk. Operational risk is shown in Table 4 Capital Requirement.

All operational activity is outsourced to the Canada Branch and is carried out by the employees of the Canada Branch or TNTC. TNTCC does have moderate inherent operational risk which includes the oversight of the outsourced operations. Employment Practices and Workplace Safety risk is not inherent to TNTCC.

## INTEREST RATE RISK IN THE BANKING BOOK

Interest rate risk is the risk of loss due to significant unexpected changes in interest rates.

The TNTCC ALCO Policy has been established and is maintained by the Board to govern activities related to interest rate sensitivity, liquidity, the pledging of assets, and large exposures in accordance with the OSFI Guidelines.

TNTCC's assets are generally held to maturity to meet one or more of the following objectives: provide interest income, manage interest rate risk, comply with applicable regulatory requirements or ensure adequate liquidity. Pursuant to the ALCO Policy, TNTCC may acquire debentures, bonds or other debt instruments of the Government of Canada or guaranteed by it; or deposits in banks, subject to TNTC's list of approved counterparties and limits. These investments are also subject to the volume, maturity, and credit guidelines outlined below.

Equity is the dominant funding source for TNTCC and the vast majority of the assets at September 30, 2013 are short-term Canadian government securities with an average maturity of approximately six months. As a result, TNTCC has minimal exposure to interest rate changes from a loss perspective.

## Table 8 - Maturity and Size Restrictions

The maximum maturity of new purchases of an instrument and the total holdings obligations of a single issuer are limited according to the following table as defined in TNTCC's ALCO Policy:

Instruments	Maximum Maturity	Maximum Holdings of a Single Issuer	Concentration limits as % of Assets
Canadian Federal Government Securities	5 Years	No Limit	Sufficient to meet Regulatory Capital Requirement
Money Market Assets (deposits in banks)	3 Months	Available Credit Limit	No Limit

TNTCC measures interest rate risk by reference to OSFI's "Interest Rate Risk and Maturities Matching Return" (I3 Return). The cumulative one-month gap and thereafter in each period defined by the I3 Return should not exceed one hundred per cent (100%) of TNTCC's total equity.

## ANNUAL REMUNERATION OF KEY MANAGEMENT PERSONNEL

Key management personnel are defined as those persons having authority and responsibility for planning, directing and controlling the activities of TNTCC which includes members of TNTCC's Board. The Canada Branch's management is involved in the planning, directing and controlling activities of TNTCC and as a result, the compensation of key management personnel reported below includes compensation incurred by the Canada Branch.

### Table 9 - Annual Remuneration of Key Management Personnel<sup>1</sup>

A breakdown of the Annual Remuneration of Key Management Personnel is provided in the table below:

(CAD \$'000s)	2012	2011
Total Cash Compensation	1,751	1,726
Registered Retirement Savings Plan	134	117
Share-based Payment Transactions	290	277
<b>Total Remuneration of Key Management Personnel</b>	<b>2,175</b>	<b>2,120</b>

1. As reported in the year-end audited financial statements of TNTCC